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# **The disciplinary power of accounting-based regulation: the case of building societies, circa 1960**

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# **The disciplinary power of accounting-based regulation:**

## **the case of building societies, circa 1960**

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### **Abstract**

This paper examines how accounting-based regulation was introduced through the House Purchase and Housing Act, 1959 (HPHA59) and Building Societies Act, 1960 (BSA60). It also tells how it was put into practice by the Registrar of Friendly Societies (RFS). The discussion is framed by the so called ‘disciplinary perspective’ of accounting as represented by Hoskin and Macve (1986; 1988; 1994a; 1994b; 1996; 2000). Fieldwork documents cases of intervention by the RFS under new powers granted by BSA60. These new powers were used to discipline targeted societies or those revealing inadequate use of their funds and thus, observed important deviations from specified accounting-based criteria which was generally recognized as financially sound within the industry. As a result we provide evidence of how accounting-based regulation affected the operation of the societies. This evidence amends other studies claiming that managers of British financial intermediaries disregarded accounting information in their operation and strategic plans (or that they incorporated such criteria until the 1990s).

**Keywords:** accounting-based regulation; House Purchase and Housing Act, 1959 (HPHA59); Building Societies Act, 1960 (BSA60); Chief Registrar of Friendly Societies (CRFS); the Building Societies Association (Association); disciplinary power; reserve ratio

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## Introduction

There is ample evidence of critical assessments of participants in the British market for retail deposits. First, these manifested themselves in a number of official documents: the *Macmillan Report* (1929); *Radcliff Report* (1959); the *National Board for Prices and Incomes' Report on Bank Charges* (1967); the Monopolies Commission ruling on the proposed merger of Lloyds Bank, Barclays Bank and Martin's Bank (1968); and, the *Cruickshank Report* (2000). All criticized clearing banks, and perhaps by implication other financial institutions, including building societies, for a systemic failure to provide adequate venture capital to finance British industry. Furthermore, the more recent of these reports opined that these institutions had inadequate, if not poor, internal control practices. To some extent clearing banks were responsible for the currency of these accusations as they failed to present successfully their case to the authorities (Billings and Capie, 2004).

Secondly, similar views critical of the lack of sophistication in management accounting in banks and building societies have been expressed in various academic studies (Bátiz-Lazo and Boynes, 2003; Drury, 1994 and 1998; Helliard *et al.* 2002; Innes and Mitchel, 1997; Nigthingale and Poll, 2000; Soin, 2004; Soin *et al.*, 2002). For example, Bátiz-Lazo and Boynes (2003: 33) in their discussion of the period 1945-68 state: '...there is little or no evidence to suggest that contemporary modern tools of management accounting...were being applied by firms operating in the financial sector'. In an investigation of the implementation of activity based costing (ABC) in a department of a UK-based multinational bank Soin *et al.* (2002) posed the question: 'But what of a sector such as banking where, at least in the UK, the use of management accounting was very limited?' (p. 250) and also refer to 'a similar lack of management accounting sophistication' found by other investigators (p. 260 and references therein).

Anecdotal evidence, through an informal survey of chief financial officers of building societies, documented in Perks (1977) suggested a very similar situation at these mutually owned, depositary, financial institutions. Hence, with regard to managerial practices within participants of British retail finance, it is not difficult to locate both implicit and explicit accusations of 'backwardness' (Bátiz-Lazo and Wardley, 2007; Billings and Capie, 2004; Booth, 2001; Jeremy, 1998). Given this accumulation

of views covering the more and less recent past, have British retail financial institutions always shown a limited use of, or lack of sophistication in, accounting information? Moreover, how widespread was Perks' (1997) claim that accounting guidelines were not effectively applied by building societies?

Evidence documented in this paper will amend the views summarised above suggesting a dearth accounting data informing every-day management of British retail financial intermediaries. By documenting evidence that accounting information was instrumental to discipline behaviour of these organisations, we propose that previous studies were perhaps misguided by theoretical constructs more amenable to manufacturing activities rather than considering in depth the rather different nature of services and particularly, financial services in the pre-computer era.

With this aim in mind, our study adds to accounting history literature by looking at the process introducing 'accounting-based regulation' through the House Purchase and Housing Act, 1959 (HPHA59) and Building Societies Act, 1960 (BSA60)<sup>1</sup>. Accounting-based regulation is a set of codified practices, often enshrined into law, through which financial or accounting data provide the underlying criteria for identifying a regulatory space or a set of subjects to be regulated. Prior research on accounting-based regulation is exemplified by Chen and Wang (2007), Chen and Yuan (2004) and Lapsley and Llewellyn (1991). These studies examine topics such as the effects, costs, issues (i.e. accounting manipulations) and measures in need of improvement. But with the exception of Miranti (1990), prior studies fail to provide details of how such regulation came to be socially constructed. Evidence in our paper addresses this shortcoming by examining the process through which accounting-based regulation was introduced and implemented following the passing of HPHA59 and BSA60 as well as documenting their impact on the operation of the societies.

Fieldwork is based on the examination of surviving records, including minutes, correspondences and other historical records of individual building societies, HM Treasury, the Registrar of Friendly Societies (RFS), the Board of Trade and the Building Societies Association. To assess the validity and reliability of the source

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<sup>1</sup> Reference to BSA60 is often substituted for the reference to the Building Societies Act, 1962 (BSA62) because BSA62 consolidated all relevant legislation between 1874 and 1960.

materials, a heuristic method of qualitative research, i.e. data triangulation (the use of a variety of data sources for studying the same phenomenon), is adopted to minimize the bias brought about by a single source.

The remainder of this study proceeds as follows: the next section develops the framework to be adopted in this study, i.e. the ‘disciplinary perspective’ of accounting. The third section reviews the significance of HPHA59, BSA60 and their related legislation by offering a brief history of building societies. This section also examines the process of the establishment of HPHA59 and BSA60 by focusing on the process resulting in the introduction of accounting-based regulation and the extended powers of the RFS. The fourth section examines in detail individual cases of intervention by the RFS through the powers recognized under BSA60. The final section provides discussion and conclusion.

### **Disciplinary Powers of Accounting**

According to a ‘disciplinary perspective’ represented by Hoskin and Macve (1986; 1988; 1994a; 1994b; 1996; 2000), accounting is defined as ‘a technology that writes value, and presents in that writing a space for examination’ (Hoskin and Macve, 1994: 67). Here, accounting is understood as a technology providing a specific supervisory authority with quantitative information having attributes necessary for a sort of test or examination. Relying on one of Foucault’s works, *Discipline and Punish* (1977: 185), Hoskin and Macve (1994: 69), on the establishment of modern examination in the 18th century, argue that:

it made it possible to generate for each individual examinee (and a whole population of examinees) a written ‘archive’ of their performance...[and] these examinations, in awarding numerical marks, generated a new power of calculation, rendering individuals into a population of ‘calculable persons’ as each person’s marks contributed to, and simultaneously marked as a deviation from, a newly establishable population ‘norm’...Such a form of examination promoted both behavioural discipline and the cause of disciplinary knowledge.<sup>2</sup>

Hoskin and Macve (1986: 106-7) thus indicate that the ‘examination “normalise” at the same time as it makes each individual into a case with a “case-history”’. Therefore, the establishment of some forms of documentation recording the performance, e.g. accounting record, of each individual and the related norms to judge the performance, as

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<sup>2</sup> These two aspects of the modern examination are called as ‘grammatocentrism’ (Hoskin and Macve, 1986: 129) and ‘calculability’ (Hoskin and Macve, 1986: 107).

represented by some forms of normalized accounting numbers, is necessary for the disciplinary regime to work. Here, discipline through the imposition of norms, i.e. normalization, is defined as a social process to construct an idealized norm of conduct and reward or penalize individuals for conforming to or deviating from the ideal.

As Armstrong [1994] (2006, 27) indicates, the disciplinary regime works, through 'systems of surveillance (the "disciplinary gaze")' and 'normalizing judgements' (a corrective rather than essentially retributive type penalty) (Stewart [1992] 2006, 8) 'made in the course of the tests and examinations prescribed by the relevant human sciences'. Armstrong [1994] (2006, 26) continues that:

In the prisons, clinics and asylums of nineteenth century France, sovereign power gave way to a quite different form of power, exercised in the name of behavioural reform, as this was defined by the emerging human sciences. Besides defining desirable norms of behaviour, these sciences (psychology, criminology, medicine) also defines the practitioners of reform, its human objects and the proper relationships between them. Since these relationships were importantly characterized by an asymmetry of power, Foucault used the terms 'power-knowledge' to refer generically to the human sciences.

Therefore, the necessity of behavioural reform and the establishment of knowledge about human behaviours are first needed for not only the norm of the behavioural reform itself, but also the practitioners of, and those subjects to, the reform, to be articulated.

Through the disciplinary regime, behavioural reconstruction was achieved towards the production of 'docile bodies', subjected and practiced bodies, for which the knowledge about human behaviours establishes 'regimes of truth' integral to the exercise of disciplinary power (Armstrong [1994] 2006, 27) by the supervisory authority. For differences between the simple system of accounting control, represented by standard cost system, and the regime of power-knowledge, as Armstrong [1994] (2006, 30) refers to, the indication made by Miller and O'Leary (1987, 254) is suggestive:

...accounting's facility to operate in terms of money effected a surprising metamorphosis. By concentrating on the end of result of money, accounting could standardise efficiency for a much larger group. In the case of more 'mental' type of work, it could simply express expectations in terms of a money outcome, leaving uncertain the question of means.

Armstrong [1994] (2006, 30) argues that 'disciplinary regimes were concerned with moulding the actual details of individual conduct, initially for the purpose of behavioural reform itself, later for the sake of the productivity of disciplined effort',

though he adds that '[a]ccounting, whether in the form of standard costs, budgetary controls or financial reports, does not do this. Methods are not specified within accounting systems, only results.' (Armstrong [1994] 2006, 30).

Financial information disclosed in the annual accounts themselves certainly do not present how specific accounting numbers or ratios should be improved, but the knowledge of the entire accounting mechanism made it possible to suggest methods for improvement. Indeed as will be evident below, when guiding specific societies to improve their performance, the Registrar of Friendly Societies (RFS) clearly recognized how the reserve ratio indicated in the annual accounts of a society could be improved by suggesting, as examples of the methods available to do so, 'consolidation of the financial positions' by retarding the rate of growth and 'economy in administration' by reducing expenditures on advertisement.<sup>3</sup>

Foucault himself is regarded as having been indifferent in analyzing the purposes of the disciplinary regime for which docile bodies are produced. According to Armstrong [1994] (2006, 31), Foucault's 'commitment to a politics of emancipation expressed itself in a concern with the immediate "microphysics" of power, rather than with the intentionalities behind it or the sovereignty in whose name it was exercised'. However, Armstrong [1994] (2006, 32) adds that institutional characteristics 'which may be irrelevant to the operation of these institutions considered as disciplinary regimes may yet be important as influences on their accounting systems'. Armstrong [1994] (2006, 32) therefore problematizes the approaches so far taken by disciplinary perspective of accounting by arguing that 'it is noticeable that many Foucauldian studies of accounting have operated at very high levels of generality, at which institutional differences have not been at issue'.

Armstrong [1994] (2006, 34) also emphasizes the need to examine in detail 'disciplinary blockades' in which power-knowledge was articulated. They appear 'as coherent, able to mould individuals according to the "normalizing judgements" built into them, able to cope with any residual internal challenge as a matter of routine, and as economically effective'. Armstrong [1994] (2006, 34) adds:

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<sup>3</sup> FS23/283, a memorandum prepared with the Registrar on the reserve ratio as one of the conditions for trustee status

An identification of accounting systems with disciplinary regions, therefore, carries the implication that, once they are in place, they should mesh unproblematically with other 'forms' of disciplinary power, produce functionally appropriate 'subjectives' and prove effective as means of maximizing outputs.

Armstrong [1994] (2006, 40) views that 'Foucault's paradigmatic portrayal of disciplinary power was in the setting of what Goffman (1968) had earlier termed 'total institutions', which are characterized with 'continuous exposure of their inmates to a certain moral and material order, with countervailing influences excluded' (Armstrong [1994] 2006, 40). However, the existences of such type of institutions are rare in the real world, excluding some exceptions such as the institutions of prison. Therefore, Armstrong [1994] (2006, 41) suggests that:

...disciplinary regimes will *not* function solely, or even primarily, through the creation of fitting identities but will, as Foucault recognized at the empirical level, encounter resistance. Accordingly, the system of surveillance and performance norms will act primarily as a conduit for material sanctions, rather than as a means of hegemonic control.

As will be evident below, by 1960 the power and duty of the RFS had gradually been expanded to cover the entire life of a building society from 'examination of the proposed rules of any society applying for registration, or of any amendment in its rules' to 'the termination of societies by dissolution, amalgamation or transfer of engagements; and the power to cancel registration of a society'<sup>4</sup>. The power of the shareholders and auditors of an individual society, even though they were concerned with the management of the society, could not countervail the RFS's supervisory power. It was only the Building Societies Association that the possibility of so doing existed, but, as seen in the next section, the interests of the Association and of the RFS were fundamentally in agreement with emphasizing the importance to achieve financial stability in the operation of a building society for the maintenance of the high standard of probity identified with the building society movement.

However, even if the authority of the RFS was so powerful, the sanction of approving the establishment, or the dissolution, of a society only was too extreme to be practicable nor effective in guiding normalization in which those financially unsound and smaller societies unaffiliated with the Building Society Association were guided to improve their financial position. Therefore, it was necessary to provide the RFS additional powers to intervene into the societies' fund raising activities. These activities

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<sup>4</sup> <http://www.nationalarchives.gov.uk/catalogue/displaycataloguedetails.asp>, accessed on 15 July 2010



had material impact on the businesses themselves as well as the interests of the stakeholders. Such measures were introduced under BSA60 and gave Sir Cecil Crabbe, Chief Registrar of Building Societies (CRFS), new powers, namely to issue an order prohibiting advertisement and/or acceptance of investments by a society suspected of irregular behaviour.

### **The Social Formation of the Accounting Norm**

#### *Brief Business History of Building Societies, 1770-1960*

Building societies are mutual financial organizations owned by long term depositors and mortgage borrowers while specializing in liquidity creation by turning retail deposits into mortgage loans. The first society was formed in Birmingham in 1774 and societies soon began to spread out across the Midlands and the North of England in the second half of the 18th century to enable working and lower-middle class people to purchase or build their own houses. By 1825 there were at least 69 societies (Jeremy, 1998: 299). All the early societies were ‘terminating’, that is, consisting of a limited number of members and disbanded after their original members had all made house purchases or received the agreed upon value of their shares.<sup>5</sup>

In 1836 the Benefit Building Societies Act gave them legal form by extending the privilege of incorporation upon application, required general meetings of members ‘from Time to Time’ (caps in original), exempted interest payments from usury laws and required individual societies to draft, certify and submit to the RFS a copy of their rules (which could include details as to how loans were advanced and interest to investors paid). Growth in the number of societies accelerated from the mid-19th century as part of the Victorian thrift movement and following the apparition circa 1846 of ‘permanent’ societies. By 1895 there were 3,642 individual societies (Jeremy, 1998: 299).

The origins of their industry body date back to the same period. It was established in 1869 as the Building Societies Protection Association. One of the main objectives of the rather small number of societies that came together was to observe and influence the deliberation process of legislation related to building societies in Parliament and maintain, and if possible expand, their privileges, rights and interests (Boléat, 1981: 58). The first test of that aim came soon enough, when the Association became involved in

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<sup>5</sup> The last terminating society was wound up in 1980.

the formulation of the Building Societies Act, 1874. Specifically representatives of the Association engaged in discussions which resulted in the Act of 1874 limiting the activities of building societies to set up a fund to make advances to members upon security of a freehold, leasehold or copyhold estate (section 14) and to ‘building and owning land for the purposes of conducting their business’ (Boléat, 1986: 2). These limits were to be controlled and implemented by the RFS (which now was named registrar of building societies – sections 4, 10 and 17). The RFS could also veto the content of any society’s rules (section 10).

The Act of 1874 was the first to define a ‘permanent’ society, namely as one ‘which has not by its rules any such fixed date or specified result, at which it shall terminate’ (section 5). It also was the first to require financial statements (section 40). These had to be filled with the RFS a fortnight after the annual general meeting and failing to do so resulted in a fine of £5 (section 43). This Act also stated that societies could not be trustees of the deceased. The society had to return funds and/or investments of investors who died, after making sure funds returned to the right person should the investor died intestate (sections 29 and 30). The Act specified that investments of liquid funds were limited to government securities (section 27).

The demise of the Liberator Permanent Benefit Building Society in 1892 led to the introduction of the Building Societies Act, 1894. It was the first to require full accounting disclosure and professional audits (sections 1, 2 and schedules). It defined an auditor as ‘a person who publicly carries on the business of an accountant.’ (section 3). It also required auditors to inspect mortgage deeds and certificates of securities (section 16). It prohibited the establishment of societies making advances by ballot, or dependent on any chance or lot, and provided an easy method by which existing societies could discontinue the practice of balloting for mortgages (Boléat, 1986: 2).

But more important, the 1894 Act broadened the power of the Registrar. For instance, the RFS was to prescribe the form for general use to report on details of financial statements as well as investments, loans, etc. (section 2 and schedules). Upon the application of ten members, the RFS could order an inspection of the financial records of a society, but it did not confer upon individual members the right to inspect these documents (section 4). Upon the application of one-fifth of the members, the

registrar could order an inspection into the affairs of a society or investigate its affairs with a view to dissolution, and even in certain cases to proceed without an application from members (section 5). It also gave him ample powers to deal with a society by removing it from the registry, when its investigations proved it insolvent or when the society failed to make a return (sections 6).<sup>6</sup> But at the same time, it gave the societies an opportunity to appeal.<sup>7</sup>

As in the collapse of the Liberator society in 1892, the ‘Borders case’ in 1937 was followed by the Act of 1939, which restricted the forms of mortgage security that building societies could accept and provided that societies ‘were deemed to warrant the reasonableness of the price of property unless borrowers were specifically informed to the contrary’ (Bol  at, 1981: 11). One further case took place in June 1959, when the State society collapsed as a result of its directors making mortgage advances, without proper security, for bridging finance in take-over bids to a company in which the same directors also held board positions. This episode became known as the ‘Jasper affair’ and led to the expansion of the disclosure requirements in BSA60 (see further Batiz-Lazo, 2006; B  tiz-Lazo and Billings, 2011; Noguchi and B  tiz-Lazo, 2010). In particular, the requirement to present a true and fair view, as the comprehensive and highest regulatory provision for the information to be disclosed in the accounts of building societies, was introduced following the same general requirement of the Companies Act, 1948, the fundamental idea of which was that legislative intervention by detailed prescription was feasible (Bircher, 1991: 152) for company financial reporting, rather than leaving it to a voluntary basis. The Institute of Chartered Accountants in England and Wales, authoritative auditing practitioners, had since 1942

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6 Section 6(1) - Where the registrar is satisfied that a certificate of incorporation has been obtained for a society under the Building Societies Act by fraud or mistake, or that any such society exists for an illegal purpose, or has wilfully and after notice from the registrar violated any of the provisions of the Building Societies Acts, or has ceased to exist, the registrar may, by writing under his hand, with the approval of the Secretary of State, cancel the registry of the society, or suspend the registry thereof for any term not exceeding three months, and may, with the like approval, renew such suspension from time to time for the like period.

7 For instance, section 5(b) stated: ‘Where evidence is furnished by a statutory declaration of no less than three members of a society, of facts which, in the opinion of the registrar, call for the investigation, or for recourse to the judgment of a meeting of the members. Provided that the registrar shall forthwith on receipt of such declaration, send a copy thereof to the society, and such society shall, within fourteen days from sending such copy, be entitled to give the registrar an explanatory statement in writing by way of reply, thereto.’ While section 6(3) said: ‘A society may appeal from the cancelling of its registry, or from any suspension thereof for a term exceeding six months, to the High Court in England or Ireland or to the Court of Session in Scotland and thereupon the Court may, if it thinks, it just so to do, set aside the cancelling or suspension.’

come to issue the series of Recommendations on Accounting Principles, the first systematically detailed official guidelines for financial reporting issued in the UK, which provided the persuasive ground for the new idea. By incorporating the same regulatory requirements, BSA60 was expected to provide relevant and effective information, through which parties concerned, included the RFS, were able to identify, understand and monitor the use made of individual society's funds and the state of its affairs.

In summary, the above episodes of fraud and scandals left the impression that important regulatory innovations were introduced following the demise of a building society (Drake, 1989: 90). Although there were amendments in subsequent legislation, the 1894 Act remained the main statute regulating disclosure until changes were introduced in 1958 and 1960. The discussion now turns to these regulatory innovations.

#### *Achieving Trustee Status for Deposits in Building Societies, 1954-1958*

Tory governments of the 1950s introduced a number of policies to encourage private owner occupancy. Those of 1954 left at a disadvantage people who wanted to buy a house built before 1919. In order to address this, the government proposed making advances through building societies. The societies agreed to take on the added risk but in return they asked for the designation of their deposit as trustee investment.<sup>8</sup> Trustee status was important because, as mentioned above, without its guarantee and in the absence of specific testamentary directions, the trustee of an estate was required to disinvest from a building society. But for the societies, designation meant more than an increase in loanable resources.<sup>9</sup> They first sought to overturn provisions of the 1874 Act and gain trustee status for investments in their 'shares' and deposits in the mid-1920s (Humphries, 1987: 335). Since then, trustee status was increasingly seen as a potential source of 'competitive advantage.' (see Bátiz-Lazo and Billings, 2011).<sup>10</sup>

Securing the long sought after goal of trustee status was one of the results of long standing negotiations between the government and the building societies industry body (which had been renamed Building Societies Association, hereafter Association, in

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<sup>8</sup> The Housing Act 1959 gave trustee status only to deposits in the societies but the Trustee Investments Act 1961 then included 'share' investments.

<sup>9</sup> 'Building Society Deposits Given Trustee Status', *The Times*, 06-Nov-1958, p. 16.

<sup>10</sup> 'Trustee Status for 130 Societies', *The Times*, 19-Jun-1959, p. 19.

1926). Following these negotiations and the advance degree of agreement between government official with representatives of the Association, on 5 November 1958 a new scheme for house purchase was put forward for public consultation. This document specified the conditions through which individual societies could achieve trustee status.

Immediately after its publication, considerable correspondence arrived at the Association, the Treasury and the RFS from a number of societies.<sup>11</sup> On the one hand, most large societies were supportive of the details within the proposal. For instance, A. Denham, president of the Halifax (traditionally the largest of them all and at the time non-member of the Association), considered that his society could easily achieve the proposed reserve ratio of 2.5 percent and in fact argued that 5 percent would be more appropriate.<sup>12</sup> Indeed, the reserve ratio of leading societies such as the Halifax, Abbey National, Leeds Permanent and Provincial were all exceeding levels of 3 percent at the end of 1957.<sup>13</sup>

On the other hand, the concern of most small societies was how to comply with the proposed reserve conditions because reserve ratio and another related accounting criterion, liquidity ratio, had been dwindling as the demand for private housing had expanded during the 1950s (see further Bätz-Lazo, 2006; Bätz-Lazo and Billings, 2011). The view of Robert Stoddart, general manager of the Dunfermline, a Scottish society, was representative of that of many other small societies as he insisted that 2.5 percent was too high and subject to change (if prices of government bonds fluctuated).<sup>14</sup>

But Stoddart's and other similar views were disregarded as 'not officially supported by the Scottish [Building Societies'] Association'<sup>15</sup>. This statement clearly illustrates the importance the regulatory authorities attached to industry bodies. Any representation by a society lacking such support was ignored or overlooked. Evidence to this emerged in the same RFS official's rebuttal to the Dunfermline, as he added that 'the conditions [for the purpose of trustee status]...are intended to ensure that so far as is practicable a society is efficiently and prudently managed...the observance of the conditions will go a

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11 FS23/283, a letter from the Assistant Secretary of the Association, N.E. Griggs, to the CRFS dated 18 November 1958

12 FS23/283, the minutes of a discussion with the CRFS held on 25 November 1958

13 FS23/283, the data for reserve ratios of leading societies.

14 FS23/283, memorandum submitted to the CRFS dated on 3 February 1959.

15 FS23/283, a letter from D. Leigh to R.D. Cramond at the Department of Health for Scotland dated 18 February 1959

long way towards establishing financial stability and therefore general security to investors'<sup>16</sup>. The letter concluded that 'Mr. Stoddart for obvious reasons, overstresses the point about trustee status being placed at the mercy of stock exchange valuations'<sup>17</sup>.

The RFS defended the proposed introduction of a reserve requirement grounding its argument on the analysis of data summarised in Table 1 below.

**[Insert Table 1 around here]**

The core argument of the RFS analysis evolved around the '[p]ercentage of societies which [will] qualify in all respects of the total assets of all building societies is 88.08%'<sup>18</sup>. Here note that the CRFS, Sir Cecil Crabbe, justified the introduction of a reserve ratio as criterion to qualify for trustee status by utilizing the percentage of the sum total assets rather than the number of societies that would potentially qualify. To us this suggests that there were plans from the outset to exclude a number of small-sized societies from trustee status (thus potentially placing them at a competitive disadvantage).

The passing of the HPHA59 established a minimum threshold of half a million pounds in total assets to qualify as trustee. After some dispensations, of the 732 registered societies in December 1959, there were 218 societies (including four non-members of the Association) whose assets had been designated as one in which trustees could deposit trust funds. The sum of total assets of these 218 societies was estimated at £2,994,000,000, equivalent to 94% of the assets of all registered societies at the end of 1960 (Registry of Friendly Societies, 1961: 6). Moreover, the introduction of a minimum net reserve ratio (of 2.5 per cent of net assets at the end of 1960) and a minimum liquidity requirement (of 7.5 per cent of total assets at the end of 1960) through the HPHA59 marked the first time any British financial institution was subject to a statutory requirement for capital adequacy.

*Strengthening Powers of Supervision, circa 1955-1965*

As noted above, the Act of 1894 was the first to give the RFS powers to investigate

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16 FS23/283, a letter from D. Leigh to R.D. Cramond at the Department of Health for Scotland dated 18 February 1959.

17 FS23/283, a letter from D. Leigh to R.D. Cramond at the Department of Health for Scotland dated 18 February 1959.

18 FS23/283, Analysis of building societies – qualification for trustee status.

potential deviant activities by directors of individual societies and as a result intervene into their operation. During the 1950s, these powers were discharged under section 11 of the Prevention of Fraud (Investments) Act, 1939 (PFA39), which was superseded in 1958 by a new Act with the same title and relevant section (namely Prevention of Fraud (Investments) Act, 1958 or PFA58).<sup>19</sup>

Section 12 of PFA58 provided RFS staff with powers to carry out advanced investigations of the affairs of the targeted society. The purpose of these investigations was to clarify grounds for issuing an order under section 11. Some 50 investigations were completed between 1939 and 1959, which resulted in orders being imposed on 20 societies. Without exception all of such cases were non-members of the Association. Table 2 below shows it was very difficult to revoke an order once it was issued under section 11. Only three were successfully rescinded by 1959.

**[Insert Table 2 around here]**

Table 2 summarises orders in force under PFA39 and PFA58 as of December 1965. Even though BSA60 superseded the latter, RFS staff had to oversee the process of termination and winding up for many years. Only four societies in Table 2 (namely Alliance Perpetual, Lloyds Permanent, Royal Mutual Benefit and State) had assets above half a million pounds. The majority of the societies in Table 2 had their head office in London (14 out of 17 or 82 percent) and all but five (namely Alliance Perpetual, President Permanent, Preston & Blackburn, Royal Mutual Benefit and Second St James's) had been established a few years before the passing of the relevant legislation.

According to the annual report of the CRFS for 1958, 14 investigations were completed between 1956 and 1959. The reasons for these investigations fell into one of the following three categories: '(a) the unsatisfactory financial position of the society as

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<sup>19</sup> Section 11 (1) provided that '[i]f, with respect to any building society, the registrar to building considers it expedient so to do in the interests of persons who have invested or deposited or may invest or deposit money with the society, he may by an order made with the approval of the Treasury direct that, unless and until the order is revoked, no invitation to subscribe for, or to acquire or offer to acquire, securities or to lend or deposit money shall be made by or on behalf of the society'. As in the cases of the orders made under sections 6 and 7 of BSA60, the power of the CRFS to make an order under section 11 of PFA58 was recognized as 'only be invoked when there are no other means of protecting potential investors from unreasonable risk' (FS23/287, the CRFS's letter to E. H. Boothroyd at the Treasury dated 16 March 1959).

disclosed by its accounts, (b) the lending of the society's funds on doubtful security, and (c) the use of the society's funds for financing companies with which the Society's directors [were] connected'.<sup>20</sup> Of the 14 cases, four resulted in orders issued under section 11 of PFA39 or PFA58. In other 11 cases, the RFS did not find it expedient to make an order because either remedial action was taken by the society or directors gave sufficient reassurances that appropriate action would be undertaken.

However, any society under investigation could still attract deposits, investments and issue mortgage loans while the public was ignorant of conversations between its directors and the RFS. This situation was unsatisfactory for members of the Association, who strongly advocated its end through a revision of building societies' regulation. Representatives of the Association then lobbied the CRFS, so that any invitation by a society to invest funds should be prohibited if any of the following conditions applied:

- (a) the reserves of the society are inadequate or it is technically insolvent,
- (b) the liquid funds of the society are inadequate,
- (c) the society receives any consideration for making advances, and
- (d) the society engages in undesirable activities (e.g. the making of heavy charges on the redemption of a mortgage). (FS23/287, the Association's memorandum dated 2 May 1958)

The representations by the Association were also motivated by their perception that a large number of small-sized, non-Association-member societies on the registrar were 'to all intents and purposes moribund'.<sup>21</sup> The problem was that, in their view, within the latter there was an increasing number of cases in which 'moribund' small societies had been 'taken over by a new management and revived with the object amongst others of using their date of establishment – often in the 19<sup>th</sup> century – as a sign of their worth'.<sup>22</sup> As revealed in the quote below, the Association was uneasy with the speculative nature of the activities of these new, non-member societies:

[the Association] is seriously concerned at the recent formation of societies which have been established primarily to further the activities of building or property companies or professional

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20 FS23/287, discussion at the House of Commons dated 6 March 1959. As documented below, the CRFS issued an order under section 11 of PFA58 prohibiting the Lloyds Permanent from inviting further subscriptions. The principal grounds for the decision included: (1) the unsatisfactory reserve position in relation to the total assets of the society and (2) inadequacy of security for the advances in respect of the 'Oak Farm' properties, resulting in a position of potential loss which would jeopardize the society's solvency.

21 FS23/287, A memorandum prepared by the CRFS dated 14 July 1958

22 FS23/287, A memorandum prepared by the CRFS dated 14 July 1958, see also FS23/283, a letter from P. Endbinder to the CRFS dated 17 February 1959



firms and not in order to serve public needs. These new societies automatically acquire the goodwill attached by the uncritical public to the words 'Building Society', which are almost automatically taken to imply absolute safety and a high standard of probity. (FS23/287, an additional memorandum by the Association dated 13 June 1958)<sup>23</sup>

The Association not only proposed to stipulate the conditions for the advertisement but also suggested that '[t]he Registrar should have power (subject to the approval of the Treasury) to prohibit the acceptance by a society of any investment from the public if he considers it expedient'.<sup>24</sup> The Association added that 'no society should be allowed to seek money from the public until it can...show that the affairs of the society have been prudently conducted and that it has achieved financial stability'.<sup>25</sup>

The Registrar seems to have shared the concerns of the Association. This is evidenced in his own memorandum to the Treasury, in which he stated that:

the undoubted goodwill that attaches to the name 'building society' [is misused], to obtain capital (which in view of the restrictions on borrowing it might be difficult to obtain otherwise) to be employed in lending out on security of often very doubtful character and at a high rate of interest or in furtherance of the founders' own business. (FS23/287, the Registrar's memorandum dated 14 July 1958)<sup>26</sup>

The CRFS further proposed to amend PFA58 'so that the order which the Registrar is empowered to make would prohibit not [only] the making of invitations but [also] the acceptance of any monies by way of loan or investment'.<sup>27</sup> He also requested to give his office the power to petition for the compulsorily winding up of a society directly rather than through the courts.<sup>28</sup>

That the RFS and the Association concurred on the issue was made clear to Treasury officials when the latter put forward for consultation what was to become BSA60. The Association supported the CRFS's proposal on the grounds that such power would enable him 'to deal effectively with a society which, although not contravening the law,

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23 The Treasury regarded the purpose of the Association's request as 'to control the attraction of public savings to the less reputable societies' (FS23/287, the Registrar's memorandum dated 14 July 1958).

24 FS23/287, the Association's memorandum dated 13 June 1958

25 FS23/287, the Association's memorandum dated 13 June 1958

26 It was also argued by RFS staff that '[i]t has always seemed to...be wholly objectionable that a society should be able to accept fresh capital notwithstanding the existence of an order' (FS23/287, a memorandum prepared by D. Leigh dated 13 June 1958).

27 FS23/287, the Registrar's memorandum dated 14 July 1958

28 FS23/288, the minutes of a meeting held between the Registrar and the representatives of the Association on 27 October 1959. The Registrar assumed that '[s]ocieties which are subject to an order...may act the detriment of investors for example by continuing to make advances out of monies in their possession in preference to making repayments of shares and deposits in respect of which notices of withdrawal have been given' (FS23/289, the Registrar's proposal for amending legislation undated, circa January 1960).

is not carrying out the normal functions of a building society but is using the provisions of the Acts and the prestige attaching to the words “Building Society” to mislead the public into investing in a speculative enterprise.’<sup>29</sup> Its representations to the Treasury, the Association added:

The fact that these proposals, which considerably tighten the Government’s control over the Building Societies, are acceptable to the Building Societies Association, reflects the desire of the reputable societies, most of which belong to the Association, to see a check on the malpractices of the few disreputable ones, which do not. (FS23/289, a memorandum prepared by E. W. Maude at the Treasury dated 8 January 1960)<sup>30</sup>

The passing of BSA60 saw the incorporation of the desires of the Association and the RFS. It moved away from PFA58 and gave the latter new powers through the possibility of introducing orders to prohibit specific activities, bar advertisements and limit the acceptance of new investments (detailed in sections 6, 7 and 8 of BSA60, later sections 48, 51 and 53 of BSA62).<sup>31</sup> Issuing an order under section 6(2) of BSA60 (section 48 of BSA62) would prohibit any or all of these important activities and thus, could be fatal as it would severely restrict the operations of the targeted society. Table 3 below summarises all societies subjected to intervention in the five years after the passing of BSA60.

**[Insert Table 3 around here]**

Between 1960 and 1965 orders were issue to 12 societies as listed above. These

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29 FS23/288, the minutes of a meeting held between the Registrar and the representatives of the Association on 27 October 1959.

30 The CRFS also indicated that: ‘[i]n principle we [the Association and the CRFS] are at one though differing in a number of details’ (FS23/287, the CRFS’s letter addressed to K. Whally at the Treasury dated 14 July 1958).

31 Section 6 (1) of BSA60 provided that ‘[i]f, with respect to any building society, the Chief Registrar considers it expedient so to do in the interests of persons who have invested or deposited or may invest or deposit money with the society, he may by an order made with the consent of the Treasury apply subsection (2) of this section to the building society’. And subsection (2) provided that ‘[s]ubject to the provisions of this section, while this subsection applies to a building society, the building society may not (a) accept the deposit of or otherwise borrow any money, or (b) accept any payment representing the whole or any part of the amount due by way of subscription for a share in the building society, other than a payment which fell due before the making of the order applying this subsection to the building society’.

Section 7 (1) provided that ‘[i]f with respect to any building society, the Chief Registrar considers it expedient so to do in the interests of persons who may invest or deposit money with the building society, he may with the consent of the Treasury by notice served on the building society give a direction: (a) prohibiting the issue by the building society of advertisements of all descriptions, or (b) prohibiting the issue by the building society of advertisements of any descriptions specified in the direction, or (c) prohibiting the issue by the building society of any advertisements which are, or are substantially, repetitions of an advertisement which has been issued and which is specified in the direction, or (d) requiring the building society to take all practicable steps to withdraw any advertisement, or any description of advertisement, specified in the direction which is on display in any place, or a direction which contains two or more such prohibitions or requirements’.

were a tiny fraction of 726 societies in existence at the end of 1960 (701 permanent and 25 terminating societies).<sup>32</sup> The table shows at a glance that orders concentrated on areas of high population growth and concentration of urban dwellings (London and to a lesser extent the North West, namely Manchester). Not one of these societies was a member of the Association. Only two societies (County of London Permanent and Official & General) claimed to have been established for many years. Only three societies (Eagle, Lloyd Permanent and Mancunian) had total assets above the half a million pounds, that is, the list above mostly comprises small or very small organisations. Only one society had its order revoked, namely the Lloyds Permanent in 1963. All other orders were in effect at the end of 1965.

As suggested above, the issuing of an order under section 6(2) was generally regarded as ‘the drastic step’ within the processes of supervising the behaviour of the societies.<sup>33</sup> Table 4 summarises the process for passing such orders.

**[Insert Table 4 around here]**

Then new procedure was roughly similar to that in existence under PFA39 and PFA58. First an investigation into the affairs of the society was launched (and usually completed within a calendar year). If the society failed to co-operate then the CRFS issued a written notice (under section 8 of BSA60 or section 52 of BSA62) to provide staff of the RFS with accounting books, ledgers, deeds and any other information the CRFS considered necessary. If evidence of mismanagement was found, the RFS could then issue a direction (section 7 and section 53, respectively) and/or an order (section 6 and section 48, respectively).

An order under section 6 in substance effectively signalled the termination of the society. Indeed it was common practice within the building society sector that those in financial distress were encouraged to amalgamate with larger-sized, geographically close and financially sound societies through arrangements and recommendations made by the CRFS and/or the Association (Barnes, 1985: 78, Barnes and Dodds, 1983). Hence issuing of the orders appears to have been not only an instrument to discipline

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32 The report of the Chief Registrar of Friendly Societies for the year 1960, part 5 building societies, p. 2.

33 FS23/287, a note prepared by E. W. Maude at the Treasury for the Economic Secretary dated 7 April 1959. See also Boléat (1986: 152).

specific societies but also, a warning to the broader constituency to deter other similar societies from engaging in undesirable activities.

### *Limiting Deposits From Real Estate Developers*

It is worth noting here another important feature of accounting-based regulation introduced in BSA60, namely the limitation on the annual amount of special advances.<sup>34</sup> Defined as loans which a building society could make to bodies corporate, BSA60 limit them to 10 percent of a society's total advances made during the year. This feature was important because, first, it enshrined in law the purpose of the societies to finance the purchase of dwellings by individual owner-occupiers. Second, once again the Association was of one mind with proposal made by the Treasury and the CRFS. Evidence of this emerged in correspondence from Association which stated that:

The Council would favour legislation which would restrict the total amount of advances made during any one financial year on all properties other than private dwelling units for owner-occupation to such percentage of the total amount advanced during that year as the Registrar may, with the approval of the Treasury, from time to time prescribe...The Council would regard 10 per cent. as the appropriate percentage to be prescribed at the present time (FS23/288, a letter from the Secretary of the Association, C. G. Garratt-Holden, to R. E. Grindle dated 16 October 1959).<sup>35</sup>

The Association further suggested modifying the annual accounts of building societies (published as part of Form A.R. 11).<sup>36</sup> The form was the main instrument to monitor their financial performance (Bol  at, 1986: 152).<sup>37</sup> In revising Form A.R. 11 for

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34 The demise of the State Building Society caused the Treasury and the CRFS to regard the development of 'societies...making a large proportion of their advances to companies, either on commercial properties or on large estates' as undesirable 'not only because such properties tend to fluctuate in value and so do not represent such a sound security, but also...it can easily lead to the wide scale abuse of the society's funds by an unscrupulous management' (FS23/289, a memorandum prepared within the Treasury dated around January 1960).

35 The most influential non-Association member society, the Halifax, also recognized the need for some limitations to be put on advances made during a particular year on certain categories other than owner-occupiers. They suggested that '[a]t least 80% of advances in any one year to be in respect of dwellinghouses or parts of dwellinghouses' and that '[t]he remaining 20% will have to cover advances in respect of the non-occupier purposes' (FS23/288, the Halifax's letter addressed to the Registrar dated around November 1959).

36 FS23/287, a letter from the Secretary of the Association, C. G. Garratt-Holden, to R. E. Grindle dated 16 October 1959.

37 The Building Societies Acts, 1874-1940 prescribed Form A.R. 11, which summarized annual accounts and statements for individual building societies. A.R.11 included analytical information necessary for supervision than included in normal annual accounts issued to the shareholders of the building societies More concretely, it included in its original form: general information (name of the society, registered office, date of incorporation, total membership at year end, name and address of the directors); a balance sheet (using headings for capital and liabilities: shares, H.M. Government advances, other deposits and loans; and for assets: mortgages and investments); revenue and appropriation account; mortgage losses account; other provision account; general reserve

BSA60, the RFS sought ‘to give an indication of any risk arising from the policy adopted by the directors of a society... [and] ... to show advances which are outside the category of those regarded as normal for building societies’<sup>38</sup>. The review was adopted as Schedule No.2 of A.R. 11, for which *Accountancy* reported that:

Schedule No. 2, of which Section A requires that “Special advances” made during the year to be summarised so as to show the total (analysed by amount) for persons other than bodies corporate and the total for bodies corporate. Sections B and C of the schedule requires lists with extensive details of the individual items making up these totals. The auditors are not required to deal with Sections B and C but Section A falls within the matters to be covered by their report on the annual return. (*Accountancy* 71:808, December 1960: 709).

In summary, the agreement between the overseer and the subjects of regulation played a significant part in shaping and socializing the accounting norms established through BSA60. More specifically, for the introduction of the extended power of the CRFS recognized under the regulation of BSA60, the Association expressed the view that ‘[t]he responsible Building Societies are quite prepared to see the Registrar given these powers.’<sup>39</sup> The case studies that follow document in detail how the new power of the CRFS played a pivotal role to intervene into the affairs and regulate the conduct of ‘disreputable’ societies. These interventions were triggered by low levels of the reserve ratio as a sign of potential financial irregularities.

### **Intervention of Individual Societies**

#### *Lloyds Permanent Building Society*

The investigation into the affairs of Lloyds Permanent began on April 1960, when the CRFS issued an order under section 11 of PFA58 forbidding the society or anyone on its behalf from inviting subscriptions to its capital.<sup>40</sup> According to Crabbe, ‘the directors of this society had found a way round the restrictive provisions relating to building societies whilst at the same time continuing to take advantage of the “building society” appeal to the general public’<sup>41</sup> by inviting investments utilizing the disguise of a private finance company called ‘Freehold Land Finance Company Limited’.

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account; special schedules (providing statistical information on mortgages, investments, special advances, etc.). Also several schedules detailing specific accounts were attached.

38 T233/1652, the Registrar’s draft form dated around October 1959. See also FS23/289, the Registrar’s further proposal for amending legislation dated around January 1960.

39 FS23/289, a memorandum prepared within the Treasury dated around January 1960.

40 T326/17, CRFS letter addressed to E. W. Maude at the Treasury dated 24 October 1960.

41 T326/17, the CRFS’s letter addressed to E. W. Maude at the Treasury dated 2 November 1960.

Between April and October 1960, the Lloyds Permanent received withdrawal notices for shares totalling £982,227; the repayments totalled £612,944, leaving £369,283 still to be repaid. Nonetheless, the society continued to receive substantial amounts as new investments. Crabbe described the conduct of Lloyds Permanent as a ‘ponzi scheme’ where ‘current investments are being used to repay prior applications for withdrawals and the new investments will be subject to a long delay, which would not be anticipated from reading the brochure, if application for withdrawal is made’<sup>42</sup>.

A notice made under section 8 of BSA60 was then issued on 17 November 1960.<sup>43</sup> The purpose was gathering information that would support issuing an order under section 6 of BSA60, to forbid the acceptance of any share or loan money by the society.<sup>44</sup> Besides raising concerns regarding new investments and repayments, the notice under section 8 pointed to the ‘[l]ow ratio of the reserves to the total assets of the society.’<sup>45</sup>

As explained above, HPHA59 introduced a statutory requirement for reserves as one of the conditions for trustee status. These measures did not aim to penalize disreputable societies but to give a preferential treatment to those that satisfied the conditions. The case of Lloyds Permanent, however, suggested an ongoing preoccupation at the RFS concerning the ability of individual societies to make good for bad investments. In this regard and according to estimates made by the Registrar, the sum total of general reserves at the end of 1960 for all societies was equivalent to five percent of mortgage assets.<sup>46</sup> However, the total reserves (including a ‘Mortgage Reserve’ of £10,000) at Lloyds Permanent, as shown in the audited balance sheet at 31 December 1960, only amounted to £21,370 or 0.65 percent of mortgage assets.<sup>47</sup> Hence, when exercising its

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42 T326/17, the CRFS’s letter addressed to E. W. Maude at the Treasury dated 2 November 1960.

43 Section 8 (1) provided that ‘[t]he Chief Registrar may at any time serve a notice on a building society, or any person who has in his possession or under his control any books, accounts, deeds or other documents relating to the business of the building society, requiring the building society or other person to produce to the Chief Registrar such of them as he considers necessary for the exercise of the powers which he has under the two last foregoing sections’.

44 T326/17, CRFS letter addressed to E. W. Maude at the Treasury dated 24 October 1960.

45 T326/17, Notice given to the Lloyds Permanent Building Society by the CRFS dated 17 November 1960.

46 T326/17, the interim report of the inspector appointed to investigate the affairs of Lloyds Permanent Building Society dated 17 February 1961.

47 T326/17, the interim report of the inspector appointed to investigate the affairs of Lloyds Permanent Building Society dated 17 February 1961.

new powers, the RFS began utilizing a ratio of reserves set in HPHA59 as argument to intervene and discipline adverse behaviour.

An order under section 6 of BSA60 was issued on December 1960. The CRFS also appointed Dennis Leigh as inspector to oversee that the conditions of the different orders and notices were met as well as seek a way of reconstructing the society's operation. He provided guidance for business reform through regular interviews with the directors. Leigh pressed to hold a special shareholders' meeting resulting in a merger with another (probably larger and more liquid) society.<sup>48</sup>

A new management team was put in place in February 1960 and led by Ernest Partridge, C.B.E.. At the time an M.P. (Cons) for Battersea South (1951-64) and with industrial experience, Partridge disregarded Leigh's suggestion for considering a transfer of engagements to a larger society.<sup>49</sup> Instead he set to the task of improving the system of internal control because, in his view, one of the main factors affecting the low reserve ratio was the negligent administration of loans in arrears. Indeed, at the end of 1960, of the 1,181 mortgages outstanding, repayments were in arrear in no less than 223 (19 percent) cases, of which 150 were more than two months overdue.<sup>50</sup> Partridge's complete overhaul of the mortgage department reduced the ratio of accounts with more than one month in arrear from 13 percent in August 1961 to 9 percent in May 1962.<sup>51</sup> The reserve ratio also increased rapidly, reaching £86,675 or 3 percent of mortgage assets by May 1962.

Partridge aimed to rebuild the society and achieve trustee status.<sup>52</sup> For that the

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48 See for instance, "Special Meeting being called", *The Times* dated 2 March 1961, when a special meeting was called without the need for the CRFS to exercise its powers. Note that a new board was elected in February, the AGM was adjourned from April until July

49 T326/17, the final report of the inspector appointed to investigate the affairs of Lloyds Permanent Building Society dated 18 October 1961

50 In his report Leigh had indicated that '[t]here is little doubt that many of the arrears cases would not have arisen if prompt action had been taken to remind borrowers of their obligations' (T326/17, the interim report of the inspector appointed to investigate the affairs of Lloyds Permanent Building Society dated 17 February 1961). The Lloyds Permanent's auditors, Calder-Marshall, Ibotson & Bound, also pointed out that 'the Society did not maintain a satisfactory system of control over its transactions and records', which led them to conclude that 'it failed to maintain a system of control and inspection of its books of account' (T326/17, the report of the auditors dated 2 June 1961).

51 T326/17, a memorandum prepared by E. Partridge dated 7 May 1962.

52 T326/17, A notice to the Economic Secretary by J. Macpherson at the Treasury dated 23 February 1961.

society had to be free of regulatory intervention. At the time, the CRFS was concerned with Partridge's scarce experience managing a society and supported Leigh's idea of a transfer of engagements.<sup>53</sup> As a result, Crabbe disregarded Partridge's initial claim that improvements in key accounting data were sufficient to revoke the orders.<sup>54</sup> About a year later, however, Partridge's continuing efforts paid off. In April 1963, Crabbe recognised that the system of administration had been overhauled and effective internal control set up. This together with a rise in real estate prices placed the society in sounder financial position.<sup>55</sup> Crabbe then requested the Treasury revoke the two orders made on Lloyds Permanent.

This was the first case in which an order made under BSA60 against a building society was rescinded.<sup>56</sup> However, in spite of the effort by the new management team and the revocation of the orders, the Lloyds Permanent was exposed to the excessive demands for withdrawal by depositors liberated from the restriction to do so. As a result in January 1965 the society was dismantled by transferring its engagements to the Westbourne Park. However, in our view, the actions of the CRFS and in particular its inspector were consistent with elements typified as 'systems of surveillance' and 'normalizing judgements', both representative of the disciplinary regime suggested by Armstrong ([1994] 2006, 27).

#### *Mancunian Building Society*

This was another case marked by a conflict of interest between, on the one hand, the good management of the society and, on the other hand, directors' activities in real estate sales and development. The society expanded rapidly in the years that followed its incorporation in March 1956. This was partly due to a high demand for mortgages but growth also characterised by high levels of spending in advertising, payment of investment rates above the industry average and the suspicion of servicing borrowers rejected elsewhere (while asking for repayments at above average rates).<sup>57</sup>

Soon after A. E. Brook was appointed inspector, under section 11 (3) of PFA58, he

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<sup>53</sup> T326/17, the CRFS's letter addressed to J. Macpherson at the Treasury dated 23 May 1962.

<sup>54</sup> T326/17, the CRFS's letter addressed to Partridge dated 5 June 1962.

<sup>55</sup> T326/227, A letter from Cecil Crabbe to J.I. Mck. Rhodes at the Treasury dated 1st April 1963.

<sup>56</sup> *The Times*, 19 April 1963, p. 17.

<sup>57</sup> T233/2269, the CRFS's letter addressed to E.W. Maude at the Treasury dated 24 October 1960



discovered evidence of advances to real estate companies where B. Green, the society's executive director, and his wife, another director, were directors and large shareholders.<sup>58</sup> Not only was the dominance by one man substantiated but Brook pointed to the possibility of property being sold by companies, under the control of the Greens, at a mark up while the higher price was afforded by individuals receiving mortgages by the Mancunian.<sup>59</sup> The society was also willing to accept very old property (erected before 1919) as security but without employing criteria set by or funds made available as a result of HPHA59.

In his communication with the Treasury, the CRFS noted that accumulated reserves were not of concern or placed the society at imminent risk but their level was still low when considering that the Mancunian was paying higher than average interest rates to investors.<sup>60</sup> Treasury officials agreed that Crabbe had enough evidence to justify making a direction under section 7 of BSA60, prohibiting the society to continue advertising. The direction was issued on February 1961 and never revoked. Instead new funds were attracted through personal introduction of new members by the existing ones. Growth of loanable resources was, of course, severely limited. This together with high variability of interest rates and increasing difficulties to retain and attract new staff, led directors to recommend the transfer of engagements to the Cheshire and the Mancunian was dismantled in July 1979.<sup>61</sup>

In summary, this case illustrates yet another instance when, in accordance with the original expectation of the Association, deviant activities of non-member led to their termination. In this process the CRFS problematized not only the actual level of the reserve ratio but also questioned the way reserves were being accumulated.

#### *Eagle and Law Mutual Building Societies*

The investigation into the business of the Eagle was also motivated by concerns about

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58 T233/2269, the report of the inspector appointed to investigate the affairs of Mancunian Building Society dated 6 October 1960

59 Brook's report also stated: 'there seems little doubt that the society's main raison d'être is to facilitate the business of Green's estate agencies and property companies' (T233/2269, the report of the inspector appointed to investigate the affairs of Mancunian Building Society dated 6 October 1960).

60 T233/2269, the CRFS's letter addressed to E. W. Maude at the Treasury dated 24 October 1960.

61 FS 14/1489, annual report for the year of 1978 dated 25 March 1979.

inappropriate links between the society and a property developer.<sup>62</sup> Prompted by a large press and postal publicity campaign (paid for to a large extent by the chairman, S. A. Halsall), authorities soon discovered that the society was making a very large number of loans to companies planning to develop hotels and reconvert Victorian houses into flats, but companies which Halsall controlled or was a director.<sup>63</sup>

This was not only the case of lending to ‘speculative builders’ or the poor diversification of the loan portfolio (as ‘its mortgages are too large, too few and concentrated in too few hands’<sup>64</sup>), but also one marked by poor collateral (i.e. grossly overestimating the value of properties) and exorbitant administrative expenses. The society was thus considered at risk by RFS staff. The relatively small amount of reserves compared with total assets raised further concerns about its financial position.<sup>65</sup>

The CRFS informed of his intention to make a direction to the society under section 7 (1) of BSA60 based on the above considerations and highlighting the society’s ‘[i]nadequate reserve ratio’, ‘[v]irtual control of the society by the Chairman, who is associated with companies to which large advances have been made’ and ‘[d]oubtful adequacy of security in respect of certain advances’.<sup>66</sup> The Eagle promptly appealed stating they were in the process of negotiating a merger with the directors of Law Mutual and, as a result, replacing Eagle’s board with the former.<sup>67</sup> The CRFS, however, disregarded the communication and issued a direction on March 23, 1961.

Shortly after, and as planned, the directors of the Law Mutual took over control of the Eagle. Formally, the two societies existed as separate entities but in fact they were run as one. Little distinction was made between them for management purposes and expenses were adjusted not so much in relation to who incurred them as to who could best bear them.

The situation worsened for the amalgamated societies in December 1963. The newly appointed CRFS, S. D. Musson, wrote to the Treasury asking for permission to issue an

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62 T326/849, the CRFS’s letter addressed to E. W. Maude at the Treasury dated 24 January 1961

63 T326/849, a note prepared by A. Guthrie at the Treasury dated 14 February 1961.

64 T326/849, a note prepared by A. Guthrie at the Treasury dated 14 February 1961.

65 T326/849, the CRFS’s letter addressed to E. W. Maude at the Treasury dated 24 January 1961.

66 T326/849, the CRFS’s letter addressed to E. W. Maude at the Treasury dated 24 January 1961.

67 T326/849, the CRFS’s letter addressed to E. W. Maude dated 2 March 1961.

order for the Law Mutual under section 48 of BSA62 (previously section 6 of BSA60) ‘to stop the society from taking further investments’<sup>68</sup>. Musson considered that there were: (1) insufficient reserves on mortgage assets and (2) insufficient liquid funds. In addition, the RFS reckon that ‘[s]ince 1960 not less than one-seventh and perhaps as much as one half of all the society’s advances have been made either to finance sales of properties by certain companies whose directors are directly or indirectly associated with the directors of the society.’<sup>69</sup>

The Treasury confirmed Musson’s request while suggesting to apply section 51 (equivalent to section 7 of BSA60) rather than section 48. Before prohibiting the acceptance of investments, Treasury officials wanted reassurance that ‘the 39 properties valued by the District Valuer should have been a true sample of the Society’s 182 mortgaged properties, rather than merely a selection of the bad causes.’<sup>70</sup> It is not clear from the record why RFS failed to pursue a larger sample. Instead, Musson complied with the recommendation and issued a direction under section 51 to Law Mutual on 14 April 1964.

The situation was further aggravated by July 1967. The CRFS now regarded the two societies as ‘indistinguishable administratively having the same directors, staff and office’.<sup>71</sup> Of greater concern, however, was the potential for financial losses:

As with the Eagle, the essence of the case against this [Law Mutual] society is that a large proportion of its outstanding advances are secured on properties of less value than the advance, the total difference in those cases being £41,932. At 31st December 1966 the society had reserves of £8,664 and a provision for anticipated losses of £1,800. Taking this into account the net total possible losses on these mortgages against which there is no reserve is £31,000, involving a possible loss of 6% of shareholders funds...It seems inevitable therefore that in the course of time...losses will turn out to be in excess of the society’s reserves and the investors will suffer some loss. In these circumstances the society should clearly be stopped from taking further investments. (T326/849, the CRFS’s letter addressed to R. T. Armstrong at the Treasury dated 18 July 1967)

Musson then served a notice of intention under section 48 (1) to both Law Mutual and Eagle on 25 July 1967. The two societies made oral representations. After several meetings, in October 1967, Musson informed the Treasury that directors had promised to voluntarily stop taking deposits and making new advances. For Musson, these were

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68 T326/849, the CRFS’s letter addressed to J. I. McK. Rhodes at the Treasury dated 10 December 1963

69 T326/850, a memorandum prepared by A. K. Stubbs at the Treasury dated 23 December 1963.

70 T326/850, in a letter from J. I. McK. Rhodes to the CRFS dated 24 December 1963.

71 T326/849, the CRFS’s letter addressed to **R. T. Armstrong** at the Treasury dated **18 July 1967**.

equivalent to the effects of the proposed order and in light of this he decided to postpone issuing an order.<sup>72</sup> At this point Musson expected ‘the societies...[to] gradually run down.’<sup>73</sup>

Self-control exhibited by both societies could be regarded as ‘docile bodies’ behaviour, that is, the submission of bodies through the control of ideas (Armstrong [1994] 2006, 27). But surprisingly their performance actually went well in terms of net income and they survived until the early 1980s. In this process the level of reserves grew as much as 15 percent of the total assets and more than 31 percent of mortgage assets in the case of Eagle and much more for the sounder Law Mutual. However, the original directions made to both societies prohibiting advertisement were never revoked so that the level of total assets remained close to £300,000. Then in the early 1980s other societies started to offer significantly higher interest rates. As a result investment income quickly migrated and the scale of both societies rapidly shrunk. The Law Mutual was finally dissolved in 1983 while its sister society, the Eagle, followed in 1984.

#### *Home Park Building Society*

Incorporated in May 1958 with the assets of £10,000, this society remained small at the end of 1963 having only £43,682 in total assets. The society did not seek investment funds from the public until 1962, but during 1963 investments were accepted from six new shareholders who were promised to receive interest at 4.5 percent. The possibility that the directors were seeking outside capital to replace their own money (by offering investors an attractive return) together with, ironically, a very high reserve ratio awoke the suspicions of the RFS. An investigation was launched in August 1963, the report of which was issued on April 1964 and stated that:

...this society possessed some unusual features. No interest was paid on either shares or deposits until 1963 and the society was being subsidised in other ways – no directors’ fees or staff salaries were being paid and office accommodation expenses were purely nominal. Despite this, the society’s charge to borrowers were high, mortgage interest rates of 8 and 8½ per cent being levied and entrance fees charged. (T326/229, Report of an investigation into the affairs of the society dated 1 September 1964)

Alongside their duties at the Home Park, the directors were found to operate

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72 T326/849, the CRFS’s letter addressed to R. T. Armstrong at the Treasury dated 24 October 1963.

73 T326/849, the CRFS’s letter addressed to R. T. Armstrong at the Treasury dated 24 October 1963.

mortgage finance company and real estate brokers whose properties no other building society would accept as security (because these properties were very old and some built before 1870). Whether directly or indirectly through their outside business, the Home Park directors were personally interested in at least 80 percent of all mortgages advanced by the society.<sup>74</sup>

It is worth noting how, as was the case of Mancunian, the inspectors report criticized the way the society accumulated capital reserves:

By the end of 1963, the society's reserves had grown to 11.8 per cent of its total assets. This was achieved by charging high mortgage interest rates whilst, at the same time, paying little or no interest on investment capital or deposits received... (T326/229, Report of an investigation into the affairs of the society dated 1 September 1964)

In September 1964 the CRFS issued a notice of his intention to prohibit the society from advertising once it was clear the society pursued the business interest of its directors rather than those of the investing public.<sup>75</sup> The Treasury's consent was obtained on 18 November 1964 and a direction forbidding advertisement was made on the same day. The order was never revoked until the society's termination in 1975.

The case of Home Park provides further evidence as to why directions made under section 7 of BSA60 (equivalent to section 51 of BSA62) were not easy to revoke. Cases involving this type of intervention were all involved societies that were run for the benefit of outside interest of their active directors. These chiefly involved dealings in the real estate property market.

### *London and Midland Building Society*

The investigation of the London and Midland started in February 1965 after its secretary, A. L. Low, informed that £96,000 of the society's funds (about one-quarters of the total assets) had been transferred to a company called Ducape Holdings Ltd. without any security.<sup>76</sup> The CRFS immediately requested and was granted permission to act under section 48 (1) of BSA62 to stop the society from taking further investments.<sup>77</sup> An order was then imposed on 2 March 1965 while criminal proceedings were initiated by the

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<sup>74</sup> T326/229, Report of an investigation into the affairs of the society dated 1 September 1964.

<sup>75</sup> T326/229, a letters from S.D. Musson to J.I. McK. Rhodes at the Treasury dated 4 September 1964 and 9 November 1964.

<sup>76</sup> T326/711, the CRFS's letter his letter addressed to J. I. McK. Rhodes at the Treasury dated 3 February 1965.

<sup>77</sup> T326/711, the CRFS's letter his letter addressed to J. I. McK. Rhodes at the Treasury dated 3 February 1965.

society against two of its three directors.<sup>78</sup>

On 10 November 1967 the solicitors of the London and Midland wrote to the CRFS requesting for revocation of the order. The affairs of the society were reinvestigated by the Registrar's staff. On 22 April 1968 the order was revoked following a diagnosis revealing that 'no indication...[of] any of the present directors are subject to any other outside influence by anyone in connection with the affairs of the society'.<sup>79</sup> But the order's termination was conditional for the London and Mildand to observe two undertakings namely:

(1) '[t]he society will...maintain a ratio of reserves to assets of not less than 3.75%', and

(2) '[t]he society will not make any advances the making of which would result in its liquid assets (cash and investments at market value less bank loans) being reduced to below 15% of its assets.'<sup>80</sup>

But even after revocation of the order the London and Midland could not achieve full recovery. This was already noted in a statement by the chairman, L.A.W. Noble, as early as the annual report for 1968. There he said that '[i]n common with all Building Societies the attraction of new investors is proving very difficult in prevailing conditions of high interest rates and the inflationary cost of living.'<sup>81</sup> Indeed, total assets remained of just over £300,000. The level of the reserves remained low and close to 5 percent of total assets. The society was finally dismantled in July 1979 by transferring its engagements to the London Goldhawk. However, the case of London and Midland illustrates how the level of reserves was central in the decision making of the RFS, the state authority supervising the building societies, when considering to not all issue but also revoke an order.

## **Discussion and Concluding Remarks**

Contrary to what has been stated in the literature relating to the use of management accounting within retail financial service organisations, this paper offers systematic

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78 In April 1968 two former directors were convicted of conspiring to cheat and defraud the London and Midland society (T326/711, the CRFS's letter to D. W. Thompson at Treasury dated 8 April 1968).

79 T326/711, the CRFS's letter to D. W. Thompson at Treasury dated 8 April 1968.

80 T326/711, the CRFS's letter to D. W. Thompson at Treasury dated 8 April 1968.

81 FS 14/1477, annual report for the year of 1968 dated 24 April 1969.

empirical evidence of the use of accounting information to discipline the behaviour of building societies. We draw on the analytical framework provided by the ‘disciplinary perspective’ of accounting and specifically Hoskin and Macve (1994), who define accounting as ‘a technology that writes value, and presents in that writing a space for examination’ (p. 67). Establishing forms of documenting the performance of individuals as well as recording norms to ascertain performance are necessary in order for any examination system to work (Hoskin and Macve, 1986: 106-7). Following these ideas accounting-based regulation was defined as a form of executive authority, enacted into law and which uses accounting numbers as criteria for identifying spaces and subjects to be regulated. We have documented how accounting-based regulation was introduced through HPHA59 and BSA60. We have also detailed how this regulation was put into practice and its impact on the operation of individual societies. As a result, our study adds to both accounting history as well as other systematic work employing the ‘disciplinary perspective’ as an analytical tool but which mainly draw on fieldwork amongst manufacturing organisations.

We have explored the idea of normalization (or the disciplining through the imposition of norms)<sup>82</sup> of the behaviour of building societies using accounting numbers. Fieldwork has begun with the enactment of HPHA59. The Act gave the RFS power to prescribe conditions for deposits (and later on share investments) at individual societies being granted trustee status. These requirements were the first to detail minimum capital requirements for any participant in British retail finance. They included maintaining a minimum level of reserves and liquidity as percent of total assets. It also specified half a million pounds in total assets as the threshold to be considered for trustee status – thus discriminating against the large number of small asset sized, non-Association-member societies.

Later on and in the aftermath of the demise of the State Building Society in June 1959, BSA60 introduced the concept of special advances. These codified the purpose of the societies to finance the purchase of dwellings by private individuals by limiting loans of the societies to corporate bodies to a maximum of 10 percent of total advances

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<sup>82</sup> Normalization is defined as a social process to construct an idealized norm of conduct and reward or penalize individuals for conforming to or deviating from ideal behaviour.

made during the year. To make this requirement effective Form A.R.11, the main instrument to supervise the financial performance of individual societies, was revised so that analytical accounting information could be supplied to the RFS.

The co-operation of the Association with state authorities (namely the RFS and the Treasury) facilitated the adoption of minimum liquidity and reserve ratios, a threshold size for operation, as well as limiting interaction of individual societies with corporations.

Collaboration between the Association and state authorities was also instrumental to strengthen the powers of the RFS so as to enable forbidding not only advertisements but also acceptance of new investments. The new extended powers were used without delay to intervene in societies suspected of inadequate uses of their funds. This as their reserve ratio, the chief specified accounting-based criterion, observed important deviations from the industry norm.

Each case of intervention documented above showed how, when exercising its power to make or revoke an order, the RFS used the levels of reserves as benchmark. The RFS pressed intervene societies to improve their level of reserves while aiming at more financially sound position and thus increasing security to its depositors and share investors.

The RFS held this approach to supervise societies for years after the passing of BSA60. For instance, in November 1978 and as part of its opinion to the Wilson Committee, the then CRFS lobby for the minimum level of reserves to be set statutorily for all societies (Bol  at, 1986: 153). A view that the Halifax had had for many years, as evidenced when its directors requested to the RFS that ‘all societies be made to comply with minimum requirements regarding reserves and liquidity’<sup>83</sup>. Like Halifax, the Association made a point of distinguishing member from non-member societies as the latter were all financially sound and meeting the RFS’s benchmark.

The case of the accounting-based regulation introduced through HPHA59 and BSA60 supports the idea of normalization or the use of accounting criteria in the

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<sup>83</sup> FS23/288, the Halifax’s letter addressed to the Registrar dated around November 1959.



establishment of norms and the pursuit of disciplinary powers to make disreputable societies to discharge these norms. Moreover, evidence documented above substantiates the view that normalization is more easily achievable when in accord with the interest of the main representative of the group to be regulated. The disciplinary perspective of accounting provided other important concepts to assist our analysis of the implementation of the accounting-based regulation, including:

- The concepts of ‘systems of surveillance’ and ‘normalizing judgements’ helped explain the relationship between the RFS and societies subjected to intervention. It was not simple power relation, but knowledge-based one backed by the development of the systematically detailed official guidelines for financial reporting embodying in the Companies Act 1948 and the ICAEW’s Recommendations.
- The concept of ‘docile bodies’ applies to cases of the self-control observed by some of the intervened societies, such as Eagle and Law Mutual. Lloyds Permanent and Mancunian also attempted not only to revoke the orders but also to obtain trustee status for their deposits as well as membership of the Association.
- The ideas of ‘disciplinary blockades’ or ‘total institutions’ were well suited to explain the co-operative and interdependent relationship between the RFS and the Association, clearly exemplified by the establishment of the accounting-based regulation in HPHA59 and BSA60.
- In penalizing the conduct of the Mancunian and Home Park, the RFS questioned their way they accumulated reserves. This even though their financial statements recorded high or at least not immediately risky levels in the relevant ratios. This suggested how simple system of accounting control and the regime of power-knowledge can be persuasive methods to discipline deviant behaviour (see further Armstrong [1994] 2006, 30).

In summary, cases documented in this article support the view that the analytical framework of the disciplinary perspective of accounting is sufficiently powerful to analyze not only internal performance (such as that in factory settings and centred on

labour control processes) as conducted in prior research, but also external performance of organisations (as exemplified by building societies).

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**Table 1: Estimates for Qualification for Trustee Status (as of 8 December 1958)**

	Number of societies	Percentage of total assets	Sum of total assets
Building societies which qualify in all respects	170	88.06%	£2,126,788,251
Societies which fail to qualify			
(1) being terminating societies	28	0.02%	£409,343
(2) being unincorporated societies	8	0.20%	£4,869,969
(3) having total assets less than 0.5 million (permanent & incorporated)	476	2.83%	£68,331,888
(4) unsatisfactory liquid position	50	3.26%	£78,616,516
(5) unsatisfactory reserves	17	4.82%	£116,445,613
(6) both liquid & reserve position unsatisfactory	4	0.79%	£19,125,993
	753	100%	£2,414,587,573

*Source:* FS23/283, Analysis of building societies – qualification for trustee status

**Table 2: Orders in force by Chief Registrar of Friendly Societies at the end of 1965**

(Interventions under section 11 of PFA39 and section 11 of PFA58)

Name (alphabetical)	Head office	Established	Date issued	PFA39	PFA58	Notes
Alliance Perpetual	London	1854	23-Jun-60		x	1
Blackpool	Blackpool	1937	22-Jan-51	x		
Camden	London	1957	26-Aug-58	x		2
County of London Permanent	London	1934	30-May-56	x		
County Palatine	Manchester	1956	17-Apr-60		x	
Essex Mutual	Hornchurch	1935	12-Feb-58	x		3
Fleet	London	1955	26-Sep-56	x		2
Lloyds Permanent	London	1954	06-Apr-60		x	1, 4
Moorgate	Swansea	1947	29-Apr-57	x		
President Permanent	London	1869	22-Feb-49	x		2
Preston and Blackburn	Preston	1952	01-Jan-60		x	5
Royal Mutual Benefit	London	1865	30-Nov-40	x		1, 2
Second St James's	London	1876	19-Aug-49	x		6
Southern Counties	London	1932	07-Apr-55	x		7
State	London	1931	22-Oct-59		x	1
Westminster	London	1954	09-May-58	x		
Willesden	London	1933	21-Dec-51	x		

*Source:* Report of the Chief Registrar of Friendly Societies (Building Societies), 1960-1965Notes

- 1) Total Assets greater than £500,000.
- 2) Registration cancelled in 1965.
- 3) Instrument of dissolution registered January 1962.
- 4) Orders under section 11 of PFA58 and section 6(2) of BSA60 revoked April 1963.
- 5) Registration cancelled in 1963.
- 6) Order by the court to be wound up on July 1955 (i.e. still in process of being terminated as of December 1965).



**Table 3: Orders issued by Chief Registrar of Friendly Societies, 1960-1965**

(Pursuit of powers under section 6(2) of BSA60 or section 48 of BSA62)

Name (alphabetical order)	Established	Location of Main Office	Total Assets 1960	Num of Share Investors	Num of Depositors	Num of Mortgages	Intervention Start
County of London Permanent	1934	London	201,747	387	11	81	1960
Eagle	1956	London	1,024,528	1,543	26	227	1961
Home Park Building Society	1958	London	137,259	5	15	410	1964
Law Mutual	1957	London	223,431	442	27	96	1964
Lloyds Permanent	1954	London	3,838,627	5,686	2,287	1,303	1960
London and Midland	1955	London	448,844	936	13	259	1965
Mancunian	1956	Manchester	1,054,020	1,899	169	1,367	1961
Official and General	1850	London	556,129	1,104	68	267	1963

Refuge	1958	Manchester	25,654	66	n/a	31	1963
Vanguard	1960	London	n/a	n/a	n/a	n/a	1965
Wembley	1955	London	78,577	n/a	n/a	34	1963
Wythenshawe	1958	Manchester	39,838	76	36	46	1963

*Source:* Report of the Chief Registrar of Friendly Societies (Building Societies), 1960-1965 and Building Societies Yearbook (1961).

**Table 4: Summary of Investigations by the Chief Registrar, 1960-1965**  
 (Orders, Directions and Notices issued under BSA60 – BSA62 in parenthesis)

Year	Investigations			Orders	Directions	Notice
	Started	In progress	Completed	Sec 6(2) (Sec 48 )	Sec 7 (Sec 51)	Sec 8 (Sec 53)
1960	3	0	1	1	0	0
1961	11	2	3	2	3	1
1962	7	10	12	2	1	0
1963	9	5	9	1	1	1
1964	n/a	n/a	n/a	0	1	0
1965	n/a	n/a	n/a	2	0	0

*Source:* Authors' compilation with data from the Report of the Chief Registrar of Friendly Societies (Building Societies), 1960-1965